U.S. CUSTOMS SERVICE
OFFICE OF STRATEGIC TRADE
REGULATORY AUDIT DIVISION

PRIOR DISCLOSURES
DURING A COMPLIANCE ASSESSMENT

Introduction

The submission of prior disclosures by importers and other parties and the subsequent handling of these prior disclosures by the Customs Service (Customs) continue to be an area of concern for both the importing community and Customs. Importers and other parties are increasingly re-evaluating how and when they should reveal their past violations to Customs. While Customs is responsible for enforcing 19 U.S.C. 1592 and ensuring compliance with the laws and regulations that govern U.S. imports and exports, it seeks to improve compliance and encourage parties to submit prior disclosures. The purpose of this document is to further communicate the importance of submitting a prior disclosure and to explain the benefits received by parties submitting valid prior disclosures.

Background

One of the most valuable tools available to a party when they discover commercial non-compliance before the agency does, is the "prior disclosure" provisions found in title 19 United States Code, section 1592. If the claimed prior disclosure is complete, accurate and filed before or without knowledge of a formal Customs investigation of the violations, the Fines Penalties and Forfeitures (F,P&F) officer may deem the prior disclosure valid. For example, prior disclosures must include: 1) an identification of the class or kind of merchandise involved; 2) an identification of the importation or drawback claim included in the disclosure by entry number, drawback claim number, or by indicating each concerned Customs port of entry and the approximate dates of entry or dates of drawback claims; 3) the description of the circumstances surrounding the violation, acts or omissions and a description of the material false statements; 4) the true and accurate information that should have been provided in the entry and a provision that the disclosing party will provide any additional information that has come to the attention of the concerned party within 30 days of the initial disclosure in order to assist Customs in making a determination; and, 5) a tender of the loss of duties, fees and taxes to Customs either at the time of the claimed prior disclosure or within 30 days after Customs notifies the party of Customs calculation of the actual loss of revenue. Extensions of the 30-day period may be requested by the disclosing party from the concerned F,P&F Officer to enable the party to obtain the information or data. When prior disclosures are determined valid by Customs the party concerned may be entitled to significantly reduced penalties.

Prior disclosures should be submitted to Customs officers at the port of entry where the disclosed violations occurred. A prior disclosure may be submitted either orally or in writing. In the event of an oral disclosure it must be confirmed in writing, unless waived by the F,P&F officer, within 10 days of the date of the oral disclosure. When the claimed prior disclosure is made to a Customs officer, other than the concerned Customs officer, it is incumbent upon the Customs officer to provide the disclosure to the concerned F,P&F Officer. Additionally, the receiving Customs officer must notify the Office of Investigations of the disclosure. When a tender is made in connection to the prior disclosure the Customs officer who receives the tender should ensure that the tender is deposited with the concerned local Customs entry officer. The F,P&F officer responsible for the port of entry, where the admitted violation took place, decides whether the prior disclosure is valid in accordance with 19 CFR 162.74.

When a disclosure is determined valid, Customs notifies the disclosing party and usually sets forth the reduced penalty treatment in its notice. The notification should provide instructions regarding payment of any reduced penalty, and also serves as the Customs record of the disclosed violation. In accordance with 19 CFR 162.74(g), if prior disclosure treatment is denied on the basis that Customs had commenced a formal investigation of the disclosed violation, and Customs initiates a penalty action against the disclosing party involving the disclosed violation, a copy of the "writing" evidencing the commencement of a formal investigation of the disclosed violation shall be attached to any required pre-penalty notice issued to the disclosing party pursuant to 19 U.S.C. 1592 or 19 U.S.C. 1593(a).

What is considered a "formal investigation" for prior disclosure purposes?

For prior disclosure purposes under section 162.74(g), a "formal investigation" is considered commenced on the date recorded in writing by the Customs Service as the date on which facts and circumstances were discovered or information received that caused Customs to believe that the possibility of a violation of 19 U.S.C. 1592 existed. During a compliance assessment or other audit, a Customs officer may discover information that provides a reason to believe that the possibility of a section 1592 violation exists. When this occurs, the officer dates and documents those findings. The prior disclosure regulations require that formal investigations be evidenced by such a "writing".

If the discovering Customs officer has commenced the investigation by such a "writing", the party should be notified of the findings. Although a “writing” may take many forms, during a compliance assessment or other audit a common form may be a sufficiently documented result sheet. Without knowledge of the commencement of a formal investigation, the party may still be able to submit a valid prior disclosure. If the party is notified of such findings before the submission of a claimed prior disclosure, the concerned F,P&F Officer may deem any subsequent claimed disclosure invalid.

It is also important to remember that prior disclosure is "violation specific" and that disclosure benefits ordinarily are available only for those violations fully disclosed by the prior disclosure. Further, it should be noted that the definition of commencement of a formal investigation as it relates to prior disclosure does not require the active involvement of the Office of Investigations. The writing and recording by any Customs officer of the facts and circumstances indicating the belief of a possible violation "commences" the investigation.

Consideration of Prior Disclosures during a Compliance Assessment or other audit

Customs encourages parties to identify noncompliance with Customs laws and regulations and submit prior disclosures to Customs in accordance with 19 U.S.C. 1592. It is possible that during a compliance assessment that some errors identified by the CAT during the transaction testing were discovered and reported to Customs on a prior disclosure. In situations where a prior disclosure is submitted prior to the commencement of the compliance assessment (before the date the sample of transactions is provided to the auditee) the calculation of compliance rates will exclude those errors, if they appear in the sample, unless they indicate a deficiency in the importer's system of internal control. The adjustments will be noted in the audit working papers. If the importer has implemented system improvements to prevent recurrence of systemic errors and these systems improvements have been tested by the CAT and found to have corrected the deficiency, then they will be considered when assessing the importer's compliance risk category. The compliance assessment, however, will not be unnecessarily delayed to wait for a fully implemented CIP.

Benefits Received from Valid Prior Disclosure

Benefits to the Disclosing Party:

As mentioned above, parties may receive reduced penalties if their prior disclosure is complete and valid. The penalty may be reduced to "zero" if the importation involves unliquidated (i.e. "open") Customs entries and no fraud is involved. If the entries are liquidated (i.e. "closed or finalized") and no fraud is involved, the penalty is the interest on the duties owed. If a fraudulent violation is disclosed, the penalty is reduced from the normal assessment of the domestic value of the goods to 1 times the loss of duties, taxes, and fees. If the violation involves no loss of duties, taxes, and fees, the penalty is reduced to 10 per cent of the dutiable value of the merchandise. The penalty for grossly negligent and negligent violations is reduced to only the interest on any loss of duties, taxes and fees, which is computed from the date of liquidation at the prevailing rate of interest.

Valid prior disclosures can and do save the trade community time and money. In some cases, parties have saved millions of dollars in potential penalties by submitting valid prior disclosures... but there are other benefits that often accrue to the disclosing party. By conducting

periodic self-assessment of importing activities and utilizing this provision of law, a party may be able to detect and correct errors, as well as ensure future compliance with Customs laws and regulations. Additional time and money savings often materialize in the form of reduced legal expenses and/or the elimination of lengthy Customs civil penalty proceedings. A good example of this is illustrated in the Prior Disclosure Scenario shown on page 5.

Benefits to Customs:

In this era of increased international trade with limited Customs appropriations and personnel (doing more with less), a valid prior disclosure can significantly eliminate or reduce expenditures of valuable Customs resources. Because the disclosing party does most of the work in uncovering the violation, the need for comprehensive or lengthy labor-intensive investigations can become reduced or unnecessary, and protracted civil administrative or judicial proceedings can be avoided. Virtually every Customs discipline involved in commercial compliance (e.g., special agents, regulatory auditors, inspectors, import specialists, penalties personnel, attorneys, entry specialists, etc.) benefits from having the disclosing party do the work for Customs. The time and resource-saving elements of prior disclosure permit the disciplines to devote greater energy to other compelling Customs enforcement or compliance initiatives.

Prior Disclosure Scenario

The following fictional scenario may have a very familiar ring to those of you with your hand in the importing/exporting pie:

"JANE'S STORY" - OR - "HOW I SAVED MY COMPANY $1 MILLION"

Jane is the new compliance manager for a large electronics company on the West Coast. She's responsible for all the Customs and freight matters involved with the thousands of products the company imports and exports. The company imports well over $500 million dollars of products each year. One Monday morning, she's going through the mail and comes across a letter from Customs advising her that her company has been selected for a Compliance Assessment Team ("CAT") review. The letter indicates that the team will be visiting in 6 months, and that the team would like to review company books and records relating to the classification and value of certain 1998 electronic parts imports, as well as the records relating to the company's rather extensive 1998 HTS 9802 assembled VCR imports. The letter goes on to state that during this period, it is recommended that the company undertake a "self-assessment," and consider availing itself of the prior disclosure provision as described in the Customs Regulations at 19 CFR 162.74, in the event non-compliance with the Customs laws is discovered. The document ends with contact information and the usual Customs pleasantries.

Jane puts down the letter and remembers reading about CATS on the Customs website and vaguely recollects something called prior disclosure. She races to her computer, signs on to the Customs website (www.customs.treas.gov), and searches through the link tied into importing and exporting/informed compliance. There it is - the CAT Kit! She downloads the document and while waiting, scans the site for information on prior disclosure. Bingo! She finds an informed compliance publication called "The ABC's of Prior Disclosure," and readies it for downloading. Jane spends the rest of the day going through the information she retrieved from the Web.

Five months later Jane completes a thorough self-assessment of imports covered by the upcoming compliance assessment and discovers why the company hired her in the first place. Jane finds that both the 1997 and 1998 imported electronic parts are undervalued and that all of the required HTS 9802 costs for the 1998 VCR imports were not reported to Customs. Based on her calculations, the company failed to pay Customs about $250,000, in duty. After meeting with Jane to review her findings, company executives agree to retain a Customs lawyer they have used on one other occasion. Later on, the lawyer calls Jane and informs her that based on his review of the records that Customs could pursue a section 592 penalty against the company, most likely at the gross negligence level (generally 4 times the duty loss). That would mean that the company could face a penalty of $1,000,000 plus the $250,000 in duty. The lawyer advises the company to file a prior disclosure to limit the company's liability.

Jane immediately meets with management and explains: "Ladies and gentlemen - with regard to the upcoming compliance assessment, it's either a $1,000,000 penalty plus $250,000 in duty, if we do nothing, or interest on the $250,000 plus the duty, if we make a good disclosure, the choice is yours." Fortunately, the company went forward with prior disclosure that was accepted as valid by Customs, and Jane got a nice little bonus in her paycheck.

COMMENTS: The lawyer gave Jane good advice about filing a prior disclosure. The next step and often the most difficult one for compliance managers is "selling" management on the benefits associated with disclosure. The following points may make the compliance manager's job a bit easier:

1. If you find the non-compliance during a self-assessment, it's very likely the CAT will discover it during the compliance assessment.

2. Let the money do the talking for you... For example, do what Jane did - determine the potential penalty if Customs discovers the violation and then look at the difference in numbers if you elect to submit a valid prior disclosure. In most cases, the disclosure savings are substantial.

3. It's worth noting that a valid disclosure will also, in most cases, reduce the intrusiveness and duration of an investigation or audit that could ensue if the company fails to make a disclosure and Customs discovers the infractions.